A Clear Mandate from the People

The defeat of Proposition D provides a clear and unmistakable mandate for reform.

San Diegans simply do not trust city government with more money.

Aside from the election results on Prop D, polling demonstrates the public has clear priorities for reforming city government:

Major Changes Sought: San Diegans are frustrated with a city government they see on the "wrong track." This suggests the need for major change in how city govern ment operates – not incremental or marginal change.

Support for Core Services: The Independent Budget Analyst conducted a city-wide survey in the spring of 2010 that demonstrated support for "core" city services – with public safety and infrastructure repair and maintenance placing the highest among residents' priorities.

The evidence is overwhelming that residents do not want city leaders to continue to cut core service levels.

By withholding revenue and demanding same or improved services, San Diegans are suggesting a "third way" to improving city government can be found by reducing wasteful spending and improving cost efficiencies in how services are provided.

Pension Reform As Key: In open-ended questions, pension reform jumps to the top of the list of changes San Diegans want to see implemented.

San Diegans support raising retirement ages and requiring city employees to make fair and equal contributions for the cost of their pension benefits.

Competitive Bidding: Voters overwhelmingly approved Proposition C in 2006 – which expressed support for competitive bidding in city government.

San Diegans also are concerned by recent efforts by labor unions to "stack the deck" against fair and open competition. Not only have fair and open competition measures passed overwhelmingly in San Diego county this year, but polling shows San Diego residents are strongly supportive of competitive bidding as a vehicle to achieving cost efficiencies in city government.

Public Sentiment on City Government

2 : 1

The ratio of "Wrong Track" to "Right Track" sentiment regarding the direction of city government

72%

Public support for bold pension reforms to raise retirement age, require equal contributions between city employees and taxpayers.

78%

Public support for immediate implementation of fair and open competitive bidding

Source Polls: August 2010 Competitive Edge, March 2009 Mercury Consulting, August 2009 Competitive Edge

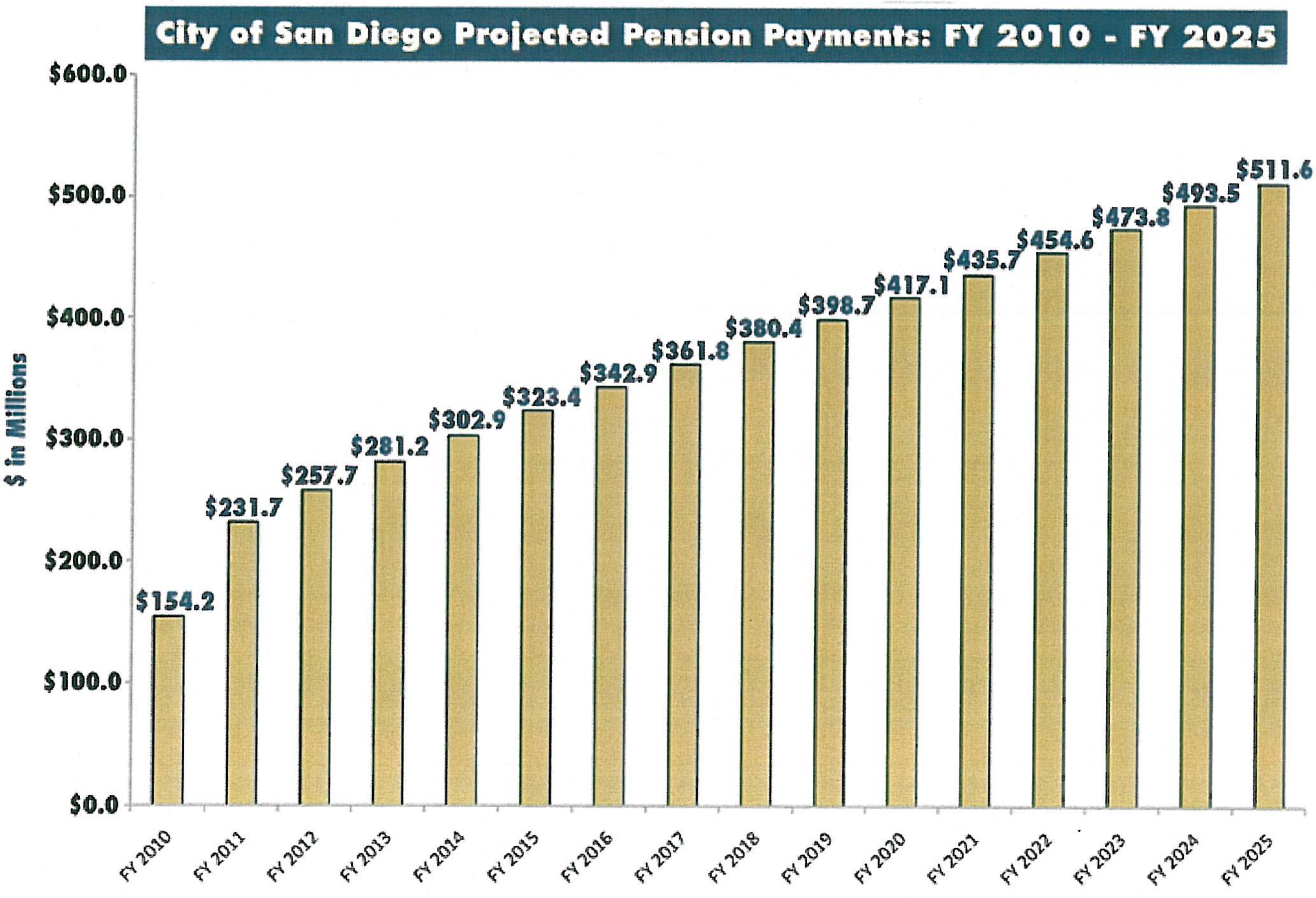
The message is clear: San Diegans want city government to cut expenses – starting with labor costs. Recent policies are patently out-of-step with these priorities.

Put simply, we cannot continue to ignore the call for reform from the public. This Roadmap to Recovery plan reflects public sentiment on what changes need to occur within our city government.

Pension Costs as Primary Driver for City's Financial Problems

Perhaps the most significant driver of the structural budget imbalance is the City's unsustainable pension liability. Put simply, until the city reforms its pension liability, no tax increase will be big enough - and no service cut will be deep enough - to satisfy the skyrocketing debt service on the city's pension system.

The city's defined benefit pension payment has climbed from $154 million last year to approximately $230 million this year. And it only gets worse. According to the pension system actuary, it will climb to $343 million in FY 2016 and spike to $511.6 million in FY 2025.



Note: Excludes other costs to taxpayers for city employee retirement benefits such as offsets, SPSP contributions, Preservation of Benefit Payments, Retiree Healthcare, etc.

As staggering as these numbers are, they do not represent the full cost of retirement benefits granted to city employees. In addition to this annual pension payment, the City of San Diego also has to fund the following costs for retirement benefits:

Preservation of Benefits Direct Payment: $1.5 Million

SPSP 401(k) Match: $6.3 Million

Offsets to Cover Employee Pension Contributions: $7.9 Million

Current ARC cost for Retiree Health Care: $120 Million (Note: the city continues to underfund this cost by only budgeting and paying $57 Million million annually – creating increased debt for future taxpayers)

When all costs for retirement benefits are totaled up in city government, they exceed $370 Million this year – or roughly $^2/_3$ of the city's entire payroll expense.

This cost structure cannot be sustained – and any organization with these excessive costs for retirement benefits would face bankruptcy in short order.

It is important to understand that the costs of servicing the City's pension debt are not going away any time soon because the debt is generally amortized over 15 years.

Comparing City Retirement Costs with Private Sector

66-68%

Percent of city payroll consumed by the cost of retirement benefits for city employees during this fiscal year

15-16%

Percent of payroll consumed by the cost of retirement benefits for typical non-profits and for-profit organizations

Source: Bureau of Labor Statistics

Unless the City takes significant actions to mitigate future payments on the unfunded pension liability, the growth rate of these payments is almost certain to outpace the growth rate of tax revenues.

The net result is that the City's pension obligations will continue to consume a greater share of General Fund resources in the coming years unless action is taken to mitigate the obligations.

As an example, under a "baseline," or status-quo scenario with all actuarial experience assumptions met, the UAL payment alone for July 1, 2012 is projected to grow by approximately 14%, year-over-year.

To put the magnitude of the pension problem in a more simple perspective, if General Fund revenues grow at a rate of 2% per year, Fiscal Year 2014 projects the City's defined benefit pension payment alone to consume more than 20% of General Fund revenue – one out of every 5 dollars.

Also, it is important to understand that the City's $230 million defined benefit pension payment is composed of $61.3 million of Normal Cost (27% of the payment.) By comparison, today's taxpayer is paying $168 million towards amortizing the unfunded pension liability, which is associated with work completed by City employees in past years (73% of the payment).

Pension debt is a real obligation of the City, and the need to pay down this debt annually will continue annually regardless of the levels of service provided by the City. As a result, it is important to focus on what can be done with the City's pension obligations to mitigate this debt payment to the extent possible.

A Closer Look at Unsustainable Pension Benefits

The primary reason why the City of San Diego's retirement costs are so much higher than the costs in the private sector and non-profit sector is due to the overly-generous nature of the benefits granted to city employees.

Councilmember DeMaio's office has already documented levels of pension payments being made to former city employees.

Getting Four Retirement Checks at Once: Some city retirees are able to receive four separate retirement benefits – including the defined benefit allowance, DROP annuity payments, SPSP 401(k)-style payouts, and preservation of benefits payouts.

Earning Almost Double in Retirement than While Working for the City: Several city retirees clearly earn considerably more in retirement than those currently working for the City of San Diego. In one case, the city's former head librarian receives $227,249 as an annual retirement allowance – versus the $139,680 budgeted amount for the current head librarian working for the city.

Six Figure Pension Payouts: Retirement system data shows a long list of city retirees earning six-figure pension payments – with the top pension payout hitting $299,103 – a figure that also does not include payouts under the SPSP retirement program.

Millions in Total Payouts: Pension reform expert Marcia Fritz has estimated the long-term payouts for the top pensioners in the City of San Diego – showing each is expected to receive between $5 million to $8 million in pension benefits. The top 10 pensioners combined are expected to receive a whopping $ 61 million dollars combined.

Million Dollar Lump-Sum Payouts: Several city retirees have accumulated million-dollar cash balances under the DROP program, which they can receive as a cash payout or as an annuity payment – all in addition to their annual six-figure pension allowances.

Shocking Facts on Pension Payouts

$2.2 Billion
The amount of unfunded pension debt in the City of San Diego

$1.3 Billion
The amount of unfunded debt for retiree health care

$227,249
The annual retirement allowance for a city librarian – plus a second undisclosed allowance. The current salary for this position is approximately $140,000

$6 Million
The estimated payout for this ex-librarian over the rest of her life

4
The number of separate retirement allowances the report finds some city employees receive.

$299,103
The top annual retirement allowance paid in CY2009 – plus a second undisclosed allowance.

31
The young age a city politician started drawing his pension

$61 Million
The estimated long-term payouts for the top 10 city pensioners

Generous Benefits for City Politicians: Additional data released from the pension system shows city politicians receiving retirement allowances at absurdly young ages. One ex-politician started receiving a pension check at age 35, another at age 39, while three others began collecting pension checks while in their forties. Several former city politicians are receiving, or in line to receive, taxpayer-funded salaries on top of their city pension.

City labor unions argue that most city retirees receive low benefits and there are only a few examples of excessive pension payouts as outlined above. However the argument they use has several flaws.

First, when unions are making those claims, they are using data includes retirees who are covered under more modest benefit packages that pre-dated the notorious Manager's Proposal 1 (1996) and Manager's Proposal 2 (2002). Those two agreements spiked benefits retroactively and have resulted in the lions-share of cost increases faced by city government.

Second, the unions exclude retirement allowances from the Deferred Retirement Option Plan (DROP) and the SPSP 401(k) program.

What does the typical general city employee receive?

The Mayor's office had the Mercer Company conduct an actuarial analysis of the pension plan for general members – demonstrating the typical city employee in that classification could receive 129% of their highest salary for life if they retired at age 67. It is important to point out that the Mercer Analysis did not include the value of DROP payments which would increase the total retirement benefits received by the city employee.

City of San Diego
General Members - Summary of Retirement Plan Design Alternatives

Defined Benefit Multiplier	
Age 67	2.80%
Age 65	2.80%
Age 62	2.65%
Age 60	2.55%
Age 55	2.50%
Defined Benefit Cap	90%
Years in Final Average Compensation	1
Defined Benefit Member Rate	10.07%
Defined Benefit Death and Disability Benefits	SDCERS
Defined Contribution City Rate	6.05%
Defined Contribution Member Rate	6.05%
Income Replacement Ratio	
Age at Hire for Illustrative Member	35
Retire at Age 67	
Defined Benefit	89.6%
Defínted Contribution	39.9%
TOTAL	129.5%

Yes, Pension Reforms Can Be Implemented

The city's labor unions and even some city leaders continue to mistakenly claim that existing pension benefits are vested and cannot be reformed.

This is simply false.

Since taking office, Councilmember DeMaio has released a laundry list of pension reforms that fall into the following categories:

Reducing the pension costs through benefits reform (new hires and existing employees)

Reducing the pension debt through reforms that achieve actuarial savings (managed competition, salary freezes, reductions-in-force, etc.)

Achieving savings in other parts of employee compensation to pay down accrued pension liabilities, (increasing employee contributions, eliminating supplemental pension contributions, etc.),

Providing incentives and vehicles for current city employees to "opt out" of higher tier benefit levels to lower, more affordable benefit tiers.

Utilizing the Charter Section 143.1 vehicle for renegotiating and adjusting benefit levels across the board for current employees.

Our pension reform plan (detailed in Commitment 4 of this plan) would solve the city's pension crisis by utilizing all of these reforms in a coordinated and integrated manner.

Recent court victories by City Attorney Jan Goldsmith – and other pending court cases – provide optimism that several reforms to existing pension benefits can indeed be implemented.

Salary Freezes: The Mayor and City Council have the legal authority to decrease annual pension payments by freezing and/or reducing payroll costs.

Managed Competition and Streamlining: The Mayor and the City Council have the legal authority to implement reforms that will reduce pension payments by implementing Managed Competition and/or direct outsourcing, and other efforts to reduce the city's pensionable workforce.

Policy on Investment Gains/Losses: Sharing investment gains and losses with employees as called for by the City Charter could lower the City's pension payments ona go forward basis. At this time, it is unclear how and whether this substantially equal investment sharing will be shared, particularly as it pertains to the invest ment losses of the year ending June 30, 2009, which were -19.2%.

Adjusting the Actuarial Model for Investment Returns: The Mayor and City Council may have to consider a reduction in the actuarially assumed rate of return, making this assumption part of pension Plan documents for the Retirement Board to follow.

Opt-Out Pension Model: The Mayor and Council may soon have the ability to put in place an "Opt-Out" model similar to that being implemented in Orange County. One option is to transfer from high-benefit tier to a lower one. However, this requires a change to IRS rule 414(h). Another option is to exit the defined benefit plan all together and enroll in a defined contribution plan on a go forward basis.

Enforcing DROP Cost Neutrality: The Mayor and Council have altered DROP benefits through the imposition of labor contracts (specifically the FY 2010 Police and AFSCME Local 127 contracts) that have yet to be implemented. SDCERS maintains that a vote of the membership is required to enact this change, while the City maintains a vote is not necessary.

While this membership election was slated to take place in September, the election be stalled until a DROP "cost neutrality" study was completed.

Reforming Discretionary Benefits: In addition to the mayor and the City Council have the ability to eliminate other "discretionary" retirement benefits, such as retirement contribution offsets, reforming terminal leave, retiree healthcare and annual contributions to the duplicative Supplemental Pension Savings Program (SPSP).

Comprehensive Settlement Vehicle: Charter Section 143.1 calls for a vote of the SDCERS membership to approve changes to the retirement system. According to the SDCERS fiduciary counsel, this Charter section grants employees the ability to vote to alter benefits that are typically considered vested, meaning the employees actually have the ability to vote to approve reductions to their benefits.

This unique section of the City Charter creates an opportunity for the City to come to an agreement with its employees to vote to alter their benefits, and could be the enabling mechanism of a pension-workout plan that mimics a "buyout" program in the private sector. Employees could benefit by securing a reliable retirement that can be sustained by a financially solvent organization, while the City would win through structurally reducing its annual costs for employee retirements.

The numerical realities suggest, it is imperative that arriving at a permanent pension solution remain the first financial priority of the City.

Ending the Practice of Creating Generational Inequity ... For Taxpayers and City Employees

As part of our civic discussion on reforming city government, it is time to have a candid and fluid discussion of "Generational Inequity" that has developed due to the crisis in the city's pension system.

Generational inequity is the practice of passing current expenses on to future taxpayers – or punishing current taxpayers for the unfunded debt for service provided to previous taxpayers. Generational inequity must be stopped.

The City's pension system (and the skyrocketing costs for servicing pension debt) is not the only example of generational inequity. Other examples include practices such as chronically underfunding retiree health care liabilities and inadequately maintaining assets to the point where the City relies on borrowing to cover past underfunding of on-going maintenance.

Generational inequity does not only impact San Diego taxpayers as a whole, it also impacts our new and younger city employees. For example, newer and younger employees are negatively impacted because their opportunities for salary increases are hampered due to the financial burden created by the unfunded benefits currently associated with their colleagues with longer service tenures.

As part of our financial recovery, the importance of inserting fresh perspectives into the City's workforce and work processes cannot be understated. Permanently resolving financial obligations associated with the past service of employees will benefit younger and less experienced employees, many of whom have nothing to gain from some of the on-going disputes over benefit levels (e.g. retiree health care benefits).

Of interesting note, it should only be a matter of time before younger city employees realize the impact to their take-home pay and financial security from policies that the "old guard" is busy defending. A sustained education campaign on fiscal realities should be conducted within the city employee base that may result in a change in direction on the part of the labor unions.

The Roadmap to Recovery is designed to tackle the problem of Generational Inequity by restructuring the city's debt, reducing our obligations, and putting into place protections to prevent these practices from occurring in the future.

Borrowing from Bankruptcy... While Avoiding It

Given the gravity of the city's financial problems, some have proposed bankruptcy as the vehicle for reform. While we strongly disagree with this vehicle for fixing the city's problems, our office has incorporated some elements from a traditional bankruptcy proceeding into this Roadmap to Recovery Plan – achieving each without the stigma, expense, and uncertainty of a bankruptcy filing.

Focus on Core Services: Bankruptcy tests a company to determine if it can be profitable once it emerges from its reorganization. The concept of "profit" in city government is different. That's why this plan focuses on ensuring the city government will emerge from its reorganization fully capable of funding and managing quality services our neighborhoods require.

Cap Annual Operating Costs: We must end chronic annual budget deficits. By comprehensively reforming salaries and benefits – while rethinking organizational precesses and opening city services up to competition – this plan produces a city government with operating costs that are sustainable both short term and long term.

Reduction of Liabilities: Like a bankruptcy proceeding, this plan relies on restructuring and reducing our financial liabilities through legal methods – with reform of pension and retiree health care benefits as top priorities. By addressing the issue of chronic underfunding for neighborhood infrastructure, the Roadmap to Recovery also tackles a looming liability in this area.

Public Vote on Key Elements of the Plan: Most importantly, the Roadmap to Recovery puts the people – not an unelected judge -- in charge of reform. The Roadmap suggests that city leaders put reforms into an irrevocable contract imposed on city leaders by the public – by placing key reforms up for a public vote at the next available election.

The City of San Diego should not look to bankruptcy as the path to reform. We have all the options for fixing the city's financial and operational problems – but we must make the tough but necessary decisions to make change happen.

Legal Authority Exists to Achieve Reform

Achieving a financial recovery and cultural overhaul of city government is entirely possible. The Mayor and City Council have the legal authority to accomplish the reforms laid out in this Roadmap to Recovery. They must simply summon the political courage.

Our City Attorney has clearly indicated that when it comes to labor negotiations, city leaders have significant leverage, and can **impose** reforms with a simple 5-vote margin.

California Government Code Section 3500 – and Council Policy 300-06 – require that the city negotiate in good faith. However, the City's labor organizations refuse to partner with City leaders in efforts to fundamentally reform City government, **the City Council has the legal authority to declare an impasse and impose reforms.**

For some pension reforms, a vote under Charter Section 143.1 may be required. However, this Roadmap to Recovery provides for a back-up reform path should unions refuse to vote to implement those particular reforms.

The City of San Diego has the legal ability to reduce its structurally unsustainable financial obligations, embrace innovative service delivery methods and emerge as a financial solvent entity that consistently provides citizens with quality and reliable public services.

"As a general rule, the terms and conditions of public employment are governed by statute or ordinance rather than by contract, and employment benefits, including compensation, may be modified or reduced as long as the City complies with any applicable procedural requirements."

- See City Attorney Opinion Number 2010-1

"If no agreement is needed at an impasse meeting, impasses shall then be resolved by a determination of the City Council..."

- City Council Policy 300-06

Legal Basis for Pension Reform Options

Reform Item	Desired State	Legal Basis
End SPSP Pension Contributions[1]	Eliminate the mandatory employer match of 3%. Given that the defined benefit plan is so generous, SPSP is no longer legally required.	YES – SPSP is a discretionary term of employment and was eliminated for one labor union in waiver process.
Eliminate Subsidy for Politicians Pensions[2]	Remove language in the city's municipal code that caps the net amount charged to city politicians for their pensions. Allow the real cost to be charged annually.	YES – Contribution rates are not vested and if challenged, either a waiver process or reduction in base salary can achieve reform goal.
Eliminate Employee Pension Offsets[3]	The City Charter requires "substantially equal" contributions by taxpayers and city employees for "cost of normal retirements."	YES – Offsets are a discretionary term of employment and were eliminated for several labor unions already.
Enact Higher Contribution Rates[4]	City employees should pay their fair share for pension benefits – taxpayers should not have to "pick up" employee contributions in addition to employer contributions.	YES – Courts have determined that contribution rates can reformed without violating vested rights.
Adopt Net Compensation Cap for Each Job Classification[5]	To force city employees to chose between salary today or big benefit payouts in retirement, the city should cap total cost of compensation (salary and benefits) per city classification. Caps should be based on the cost of reformed pension tiers for new hires. If an employee receives more costly benefits, a corresponding reduction is made in base salary.	YES – Courts have determined that employers can adjust compensation packages. The city should adopt labor contracts that contain "net caps" on compensation costs per employee classification.
Create Opt-Out Program[6]	In concert with the reforms above to increase employee contributions for the true costs of their pension benefits, an opt-out program should be created to allow employees to switch to more affordable pension tiers. Saves both taxpayers and employees substantial funds.	PENDING – From a vesting perspective, there are no barriers to implementing this reform. However, the IRS must first sign-off on opt-out programs.
Achieve DROP Cost Neutrality[7]	Contrary to claims by city leaders that DROP has been "eliminated," the vast majority of employees can still receive DROP. If an employee enters DROP, the city should reduce salary to achieve cost neutrality for taxpayers.	YES – Courts have determined that DROP can be reformed without violating vested rights – it is a term of employment subject to offset and modification.
Create New Affordable Pension Tiers[8]	To reduce costs of pensions for new hires and provide lower tiers for the Opt-Out Program, several retirement options should be provided to employees.	YES – The City can legally change pension plans for new hires. Once in place, and in concert with other reforms, existing employees can then opt-into these lower-cost tiers.
Negotiated Global Settlement and Pension Reform[9]	Provide city labor unions with a settlement plan for approval using a reform mechanism contained in the City Charter. To get deal, provide incentives (no pay cuts; fund stability; more take-home pay with lower contribution rates) and action-forcing mechanism (pay cuts, layoffs, and/or long-term pay freezes)	PENDING – SDCERS counsel and other legal experts confirm that benefits for existing employees can collectively be reformed through a vote of Charter Section 143.1.
Long-Term Pay Freeze (or Cut)	Pension liability (and associated payouts per employee) are driven by salary increases. Absent reforms above, the city can implement pay cuts and/or 5-8 year salary freeze (including no STEP increases.)	YES – Courts have determined that employers can adjust compensation packages.

1 See full memo by Councilmember DeMaio on January 21, 2009.
2 See full memo by Councilmember DeMaio on August 29, 2010.
3 See full memo by Councilmember DeMaio on January 21, 2009.
4 See full memo by Councilmember DeMaio on December 4, 2009.
5 See outline of concepts by Councilmember DeMaio in August, 2009
6 See full memo by Councilmember DeMaio on December 4, 2009.
7 See full memo by Councilmember DeMaio on October 9, 2009.
8 See full memo by Councilmember DeMaio on December 4, 2009.
9 See full memo by Councilmember DeMaio on December 4, 2009..

A ROADMAP TO Recovery

FY 12 Actions and Long-Term Actions